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C O N F I D E N T I A L SECTION 01 OF 03 TEGUCIGALPA 001310

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STATE FOR EB/IFD, INR/IAA, DRL/IL, WHA/EPSC, AND WHA/CEN
TREASURY FOR JHOEK
COMMERCE FOR MSIEGELMAN
STATE PASS AID FOR LAC/CAM
NSC FOR DAN FISK
DOL FOR ILAB

E.O. 12958: DECL: 07/21/2016
TAGS: EFIN ECON ELAB PGOV SOCI HO
SUBJECT: HONDURAN CONGRESS ABROGATES KEY IMF CONDITIONALITY
ON TEACHERS WAGES

REF: TEGUCIGALPA 1131

Classified By: Ambassador Charles A. Ford for reasons 1.4 (b) and (d)

¶1. (U) This is an action request. Please see para 11.

¶2. (C) Summary: As feared, on July 18 the Honduran Congress voted to remove the Teachers Wages and Benefits Law (Ley de Estatutos de Docente) from coverage by the 2003 Wage Reform Law (Ley de Reordenamiento del Sistema Retributivo). Removal of the teachers' wages from the reform law opens the way to continued negotiations on teachers' demands for full implementation of the &estatutos,8 which the GOH estimates will cost 5.5 billion lempiras (approximately USD 292 million, or roughly 4 percent of Honduras' GDP). Removal of the law is a violation of a World Bank conditionality and of a prior condition for the International Monetary Fund's (IMF) Poverty Reduction and Growth Facility (PRGF). Were the GOH to agree to pay the full estatutos, the GOH fiscal deficit would increase from nearly 2.5 percent of GDP (its maximum allowable target under the IMF agreement) to over 6 percent of GDP. This, too, would be a violation of the agreement with the IMF and would call into question the GOH's dedication to its professed poverty reduction goals. Given these looming crises, Post encourages Washington-based agencies to suspend consideration of any further debt relief proposals pending evidence from the new Zelaya administration of political will to maintain fiscal discipline. End Summary.

¶3. (C) EconChief spoke with IMF Resident Representative on July 18, who reiterated his earlier comments concerning the gravity of GOH moves to remove the teachers' benefits from the 2003 wage reform law. He had previously written that "The 2003 salaries law was a prior action for the PRGF. The decree before Congress would reverse this key reform. The integration of teachers' benefits with salaries, also an element of the 2003 salaries law which set up a procedure for doing that, is a key outstanding commitment, which was waived at (Highly Indebted Poor Countries (HIPC) Initiative) completion point. Reversing the law might also upend the procedure for integrating benefits, and in any case it sends a signal that this will not happen." He went on to say that reducing public sector wages as a percentage of GDP is another GOH target for 2006, and implementation of the estatutos would put Honduras out of compliance with this target as well.

¶4. (SBU) In a private conversation with EconChief on July 18 and again in public remarks to the press, World Bank Senior Economist Dante Mossi confirmed that the Congress' action is a violation of Honduras' agreement with the IMF. The next big question, he said, is where will the GOH get the nearly USD 300 million to pay for the proposed teachers' salary and benefits increases? Directors of private sector umbrella organization COHEP criticized the government for political pandering to a mere 60,000 teachers, while ignoring the Ministry of Finance report on fiscal impacts and risking a breach with the IMF. The group called on the GOH to reconsider this action so as not to put the country's macroeconomic stability at risk. They also warned that if the GOH yields to the wage hike demands of the teachers, the Congress would soon be faced with "an avalanche" of pay raise demands from unions throughout the economy.

¶5. (C) The previous Maduro administration had agreed that Honduras would resolve the teacher's issue by 2007, but by requesting a waiver of this performance criterion from the IMF (citing the November 2005 elections) they effectively left the difficult work for the next government. The new Zelaya administration, which came into office in January 2006, has rhetorically walked away from this commitment to the IMF, promising instead full implementation of the estatutos -- a promise originally estimated to cost over 7 billion lempiras (about USD 370 million, or over 5 percent of the GDP). In conversations with EconOff on July 17, Former President Ricardo Maduro presaged Congress, undoing of &the most important economic reform8 (and one of the most politically costly policies) of his administration. Maduro lamented that upon pushing the Wage Reform Law through

Congress, his approval rating fell from 65% to 15% overnight. He expressed grave concern that to begin negotiations with the teachers would be a death sentence for any new GOH-IMF agreement, and ran counter to all economic policies implemented under his watch.

¶6. (C) Former Minister of Finance Hugo Noe Pino made it clear during early talks with teachers in February 2006 that such a pay-out was simply impossible, but he was prepared to offer up to 700 million lempiras (later raised to 1 billion lempiras, or about USD 53 million) in pay raises in exchange for an agreement from the teachers to index future wage and benefits packages to inflation. The teachers immediately rejected this offer, as did President Zelaya, prompting a public spat with his Minister of Finance that contributed to Noe Pino's resignation (reftel). On July 18, Zelaya went even further, publicly announcing that his administration will not only comply with the estatutos, but will also raise teachers' salaries.

¶7. (C) This potentially severe loss of fiscal discipline is merely the latest in a series of GOH decisions to provide unbudgeted subsidies without first identifying spending offsets. The GOH has spent an estimated USD 13 million on subsidizing gasoline prices at the pump, and recently approved an unbudgeted salary increase of USD 7 million for the military. (Note: Unlike the average teacher, the average member of the armed forces is poorly paid and long overdue a meaningful raise. End Note.) The GOH has also offered subsidies to taxi and bus drivers, a transportation subsidy to students, a government waiver of student enrollment fees at all public elementary and secondary schools, and a subsidy to farmers for fertilizers and seed to further expand already unprofitable production of basic grains such as corn and beans. Excluding the teachers' wage issue, the total cost of these initiatives did not prompt a strong reaction from the International Financial Institutions, a lesson that was not lost on the teachers: recognizing that the GOH has yet to stand firm against any demand for subsidies or other handouts, the teachers pocketed their recent victory but refused to call off scheduled

strikes and street protests, and briefly blocked the main road to the airport July 19. The GOH has given them no reason not to believe that if they hold firm, they will receive everything they are seeking.

¶8. (C) These recent GOH giveaways come in addition to a series of high-profile fiscal crises the GOH has yet to resolve. Parastatal telephone company Hondutel has seen its revenues fall sharply following its loss of monopoly status in December 2005. While still a money earner, Hondutel no longer provides nearly the revenues to the GOH that it has in the past, creating shortfalls on the income side of the GOH budget ledger. In response, the GOH and Hondutel have slammed the door on further market opening by stalling telecommunications reform legislation and failing to issue new regulations that would transform current "sub-operators" (companies that entered the market in 2004-2005 under contract with Hondutel on the understanding that they would become fully independent market participants in December 2005) into true competitors. Hondutel has since begun canceling operation permits for many of these companies, alleging that they obtained the permits only for "speculative" purposes. (Comment: Post views this as a red herring, since there is no inherent value to the permit and therefore no potential for speculation. An unlimited number of permits are available for only USD 1,000 each from Hondutel. Instead, Post sees this maneuver as a means to further impede the establishment of true competition in the Honduran market. Post continues to raise this issue with Hondutel directly -- reported septel.)

¶9. (SBU) The third major fiscal crisis confronting the GOH is a steady stream of losses at parastatal electricity company ENEE. These losses are conservatively estimated at USD 120 million per year, due to below-cost electricity rates and extremely high (28 percent) technical and non-technical losses stemming from outdated equipment, poor maintenance, lack of effective metering, and theft. Recent investigations

also suggest that a number of GOH ministries have not paid their electric bills in a decade or more, and that a number of influential and politically connected industrialists have arranged to have their own electric bills "forgiven." The GOH has named a commission to investigate reform of ENEE, but so far few concrete steps have been taken that will stanch the bleeding.

¶10. (C) Comment: Unless each of these four issues is resolved soon (teachers' wages, reduced earning from Hondutel, massive losses at ENEE, and an unchecked tendency to distribute lavish subsidies), the GOH could soon find itself dramatically overshooting its deficit targets. The IMF has declined to use the phrase "off-track" thus far, preferring to give the GOH some time to gets its affairs in order. But neither has the IMF turned a blind eye, instead refusing to certify GOH compliance during its May 2006 inspection and scheduling a follow-up inspection for August ¶2006. During a recent visit, World Bank Director for Central America Jane Armitage was also very direct in her warnings that under current circumstances the GOH fiscal situation is "very fragile" and there is growing concern about recent trends towards loss of fiscal discipline.

¶11. (C) Comment continued: GOH Minister of Finance Rebecca Santos and Central Bank President Gabriela Nunez are in Washington during the week of July 17 to advocate for Interamerican Development Bank (IDB) debt relief to Honduras of over USD one billion. Post understands that the U.S. Treasury supports establishing a mechanism within the IDB for debt relief, following the HIPC model. Post also understands that internal discussions at the IDB have bogged down amid lack of consensus over such debt-relief mechanisms, and that discussion could continue throughout 2006. Post proposes that discussions on whether to establish an IDB debt relief modality be divorced from any subsequent discussions of

whether a particular country qualifies for such debt relief. In other words, any IDB decision to establish a debt relief mechanism should not presuppose which countries can then receive such relief. In the case of Honduras, automatically granting IDB debt relief based solely on previous HIPC relief would be a mistake, since fiscal conditions in Honduras have changed significantly since HIPC completion point was reached in 2005. End Comment.

¶12. (C) Action request: In the case of Honduras, Post points out that HIPC completion point and all resultant World Bank and G-8 debt relief packages were the result of fiscal disciplines imposed under the previous administration. The current administration has not shown a similar dedication to the principle of fiscal discipline, and, as explained above, is flirting with a possible breech with the IMF. Under such circumstances, Post feels it would be inappropriate to reward poor GOH fiscal policies with additional debt relief. There is still time for the Zelaya administration to constructively address these many concerns, but until they demonstrate the will to do so, Post encourages Washington-based agencies to suspend consideration of any further debt relief packages.

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